Response to House of Representatives Letter dated May 19, 2010

From Chairman John Conyers, House Committee on the Judiciary

Chairman Henry "Hank" C. Johnson Jr. Subcommittee on Courts and Competition Policy

To

Jeffery Smisek, Chairman, President and CEO of Continental Airlines

Glenn F. Tilton, Chairman, President and CEO of UAL Corporation

Question 1

In any merger, the merging firms always tout "efficiencies," which often means employees will lose their jobs. What guarantees can you provide the Committee that there will be no job losses associated with this merger?

This merger will generate substantial efficiencies, but a relatively small portion of the projected efficiencies is associated with reducing redundant job positions. Continental and United have the most complementary networks of any two network carriers: our hubs are geographically dispersed; each serves a large number of distinct destinations; and our networks present a very small number of overlapping nonstop routes. *See* Exhibit 1. This network complementarity and geographic diversity mean the merger will create substantial service benefits for consumers with little operational redundancy. This will help to maintain frontline jobs.

The merger will result in some redundancy of central corporate functions, but we expect minimal disruption to frontline employees. Reductions in frontline positions will largely be handled through retirement, attrition, and voluntary programs and we will work to minimize the number of involuntary reductions in corporate positions through voluntary programs.

Ultimately, we believe this merger will preserve jobs by creating a more competitive, financially stable, and efficient airline. By combining complementary networks, we believe United and Continental will create significant revenue synergies from service improvements for our customers. In fact, the projected merger efficiencies provide a stronger foundation to support future growth. We expect the merger will offer our employees improved long-term career opportunities and enhanced job stability by being part of a larger, financially stronger, and more geographically diverse carrier that is better able to compete successfully in the global marketplace and withstand the volatility of our industry.

Question 2

Aside from any proposed job reductions, please explain what efficiencies the companies expect to be gained from the merger and how these cost savings will be passed along to customers.

By bringing together two highly complementary route networks, this merger will give travelers expanded access to an unparalleled global network. It combines United's Midwest, West Coast, and Pacific routes with Continental's service in metropolitan New York, the East Coast, the South, Latin America, and across the Atlantic. *See* Exhibit 2.

Customers will have access to 116 new domestic destinations; 40 will be new to United customers, and 76 will be new to Continental customers. The merger will create more than 1,000 new domestic connecting city pairs served by the combined carrier, providing additional convenience to customers. *See* Exhibit 3.

Our fully optimized fleets and routes will provide greater flexibility, options, connectivity, and convenience for customers. This improved connectivity and direct service options, as well as improved service, are expected to enable the combined airline to generate $800-$900 million in annual from our improved network synergies – and these synergies are not dependent on fare increases.

Importantly, the combined airline will be better able to enhance the travel experience for our customers through investments in technology, the acquisition of new planes, and the implementation of the best practices of both airlines. The new airline will be more cost effective; we expect to realize net cost-savings synergies of $200-$300 million per year, mostly through reductions in overhead such as rationalizing our two information technology platforms, and combining facilities and corporate functions such as finance, marketing, sales, and advertising.

We will have one of the youngest and most fuel-efficient fleets among the major U.S. network carriers, as well as the flexibility to manage our fleet more effectively. With one of the best new aircraft order books in the industry, we also will be able to retire older, less efficient aircraft. This will result not only in greater efficiency but in less environmental impact from our fleet.

Once the merger is complete, customers also will participate in the industry's leading frequent flyer program, which will give millions of members more opportunities to earn and redeem miles than ever before. Through Star Alliance, the leading global alliance network, our customers will continue to benefit from service to more than 1,000 destinations worldwide.

Question 3

We understand that you have decided that the corporate headquarters of the new company will be in Chicago, Illinois and not Houston, Texas. Will this result in any loss of jobs in Houston? How many and what types of positions will be eliminated? Will any of these jobs be union jobs?

With the decision to locate corporate and operational headquarters in Chicago, part of that integration planning will include determining which functions will be in Chicago and which will be part of our significant presence in Houston. Until those determinations are made, we do not know which jobs will be located where.

While no final decisions about levels of employment at any hub have been made, we will continue to maintain a significant presence in Houston and will remain one of Houston's top private employers. Continental employs approximately 17,000 people in Houston; Continental and United have a total of 18,400 employees in Texas. The hub at IAH will be the combined airline's largest hub and will serve as its primary gateway to Latin America. Furthermore, there should be minimal impact to frontline employees and we expect a net job growth for Houston, over time.

This merger will result in relatively few job losses because the networks are so complementary. The primary overlapping functions are in central corporate operations and not in the field. We expect our co-workers to benefit from improved long-term career opportunities and the enhanced job stability that comes from working for a stronger company.

Question 4

After a merger such as this, the combined company will be required to combine salary structures and employee benefits. Some companies force employees to accept the lower of the two systems. Will you guarantee that you will offer employees of the combined company the higher of the two systems? Will you guarantee that no employee's pension plan will be reduced or eliminated as a result of this merger?

A substantial majority of the combined company's employees will continue to be represented by unions and therefore any change in salary structure and employee benefits must be collectively bargained. Current union contracts remain in effect and will be honored. Over time and through the collective bargaining process, some of our unionized work groups may want to pursue changes in pay, work rules, and benefits including retirement benefits, but it would not be right for us to speculate about what those changes might be. This merger is designed to make sure that we can provide secure retirements in the future. Both United and Continental provide retirement, health, dental, and other benefits; the merger will not impact coverage. Over time, the benefit programs for our represented employees will be harmonized through a negotiated process and we will look at health and welfare plans that are best for the combined company as a whole.

<u>Question 5</u>

We understand that after the merger the company will have eight hubs. Many have speculated that this merger will result in one or more of these hubs being eliminated. Can you commit that the company will not close any hubs? If not, which hubs do you intend to close? Will any of the employees at these hubs be offered the opportunity to transfer to other locations?

The merger will produce synergies and will increase the value of the network to consumers, which in turn will produce greater demand for the merged airline's hubs than if the two companies remained separate. When schedules and fleets are optimized by the merged airline, the enhanced efficiency and greater passenger connectivity at each hub will create opportunities for growth, not contraction. We are committed to continuing to work with the local business and civic communities of all of our hubs in order to understand the strength and market demands of each.

When we announced the merger, we said we would continue to provide service to all of the communities our airlines currently serve, including 148 small communities and metropolitan areas. *See* Exhibit 4. This service enables residents of small communities to connect through our eight mainland domestic hubs, and travel on to hundreds of destinations on thousands of routes worldwide. The combined airline will offer these travelers access to 350 destinations in 59 countries. *See* Exhibit 5.

Our industry must continually manage external factors ranging from skyrocketing fuel prices, to recession and pandemics. As such, we must maintain the flexibility to operate our business and make decisions – including the ability to grow, reduce or redeploy capacity – that enable us to compete successfully.

<u>Question 6</u>

Please provide a list of all airports in which the companies both have gates as well as any plans you have to engage in a gate swap with any other airline as a result of this merger. Further provide a list of all routes in which the companies offer overlapping service.

The merger does not contemplate a gate swap with any other airline. However, the merger will allow the combined carrier to more efficiently utilize airport facilities and to return some gates to airport authorities for allocation to other carriers. Appendix A provides a list of all airports in which both Continental and United have gates.

United and Continental have no international nonstop overlaps. Of the thousands of routes that each individually serves, there is overlapping nonstop service on only 15 domestic routes: Washington-Houston; Los Angeles-Houston; Houston-San Francisco; Denver-Cleveland; Chicago-Houston; Denver-Houston; Chicago-Cleveland; Washington-Cleveland; Denver-New York; Los Angeles-New York; Chicago-New York; New York-San Francisco; Washington-New York; Los Angeles-Honolulu; and Los-Angeles-Maui.

Question 7

Access to affordable airfare is a necessity to the flying public, and yet this merger will reduce the options that customers have in some markets. What assurances can you provide the Committee that prices will not increase because of this merger? Please provide a list of any market in which the number of commercial options will be reduced from 3-2 or 2-1 as a result of this merger.

The airline industry is intensely and increasingly competitive, placing significant downward pressure on fares. As a result, airfares have declined by more than 30 percent over the last decade on an inflation adjusted basis. *See* Exhibit 6.

The strong, steady growth of LCCs has changed the competitive landscape fundamentally over the last decade. LCCs operate profitably at lower unit revenues than traditional network airlines, generally due to significant cost advantages related to their low wages and benefits and less costly point-to-point business model. Despite continuous efforts by network carriers to reduce costs and become more efficient, LCCs have nearly doubled their share of U.S. domestic passengers and now account for nearly 40%. *See* Exhibit 7. Southwest has the largest domestic passenger share of any airline, and will continue in that position after our merger. The merged Continental-United will be only third, following Southwest and Delta. *See* Exhibit 8.

More than 85% of passengers traveling non-stop on either Continental or United have an LCC alternative. *See* Exhibit 9. LCCs compete on more than 90% of Continental's and United's 50 largest routes, compete directly at all of our hub airports, and have very large presences at other airports in our hub cities (e.g., Hobby in Houston, Akron near Cleveland, BWI near Washington, and Midway in Chicago). LCCs have shares in our hub cities ranging from 28% in Cleveland to 50% in Denver and San Francisco. This LCC presence alone is sufficient to ensure that pricing will remain competitive.

Post-merger prices will continue to be heavily influenced by the fierce competition in the airline industry, not only by existing LCC and network nonstop competitors, but also by connecting traffic and the threat of new entry. LCCs have continued to enter and expand their presence in nearly 90% of the highest traffic routes served by the carriers, and this trend is expected to continue. As described by Southwest CEO Gary Kelly, LCC entry and expansion would deter or counteract any attempt to increase prices following a merger: "To politicians who worry that domestic competition would suffer if [a merger occurs], Mr. Kelly said, 'We can put those fears to rest.' He said Southwest would quickly move in to expand service."1[1]

Price competition in the airline industry has also increased due to the ready availability and transparency of fare information to consumers through online sites such as Expedia and Orbitz. Consumers have become more savvy and sophisticated as they search for the fare that meets their needs. "[R]aising airfares isn't like raising the price of milk . . . the internet can hunt the cheapest fare worldwide in seconds. If one carrier has some empty seats to fill, it will have to cut the price because getting something for that seat is better than flying it empty." (Scott McCartney, "As Airlines Cut Back, Who Gets Grounded", *Wall Street Journal*, 6/5/08). Online sites have expanded their business models and now offer targeted services to corporations and business travelers.

This merger produces more than 1,000 new connecting city pairs, creates an integrated network serving hundreds of destinations, and improves service and access for millions of passengers. Within this broad combined network, the merger presents very few direct overlaps, and on each overlap route the merged carrier will face substantial competition. Indeed, the Continental-United merger will not produce a single 2-1 nonstop overlap, and it will produce only four 3-2 non-stop overlaps: Washington-Houston; Los Angeles-Houston; Houston-San Francisco; and Denver-Cleveland. A low cost carrier ("LCC") is the primary third-party competitor on each of these routes: Southwest is a larger non-stop carrier than United on each of the three Houston-based routes; and Frontier is a larger nonstop carrier than both Continental and United on Denver-Cleveland. Moreover, each of these routes also will be served by at least four other airlines offering significant connecting service. *See* Exhibit 10.

We do not believe that the merger can facilitate any price increases, nor do we plan any price increases due to the merger. None of the revenue synergies expected from the merger is modeled on a fare increase.

<u>Question 8</u>

What service changes can we expect to see as a result of the merger? Specifically, will any routes have service reduced or eliminated?

As noted in response to Question 5, the combined carrier will continue to serve all of the communities that Continental and United serve currently. The merger will result in over 1,000 new domestic city pairs, as well as in new domestic and international merger-enabled routes. The carriers will announce their new service offerings after they obtain the relevant regulatory approvals and close the transaction.

1[1] *Southwest Is Waiting in the Wings*, The New York Times, May 6, 2008 (quoting Southwest CEO Gary C. Kelly).

Question 9

What will be the effect on support business, such as food service and baggage handlers, who may not be employed by Continental or United but who may be impacted by the merger? How many of these types of jobs do you expect will be eliminated?

Because our route networks are so complementary with minimal overlap, and because we plan to serve all communities we serve today, there should be minimal impact on the overall level of operational support the combined company requires from outside providers (e.g. food service and baggage handlers). In fact ultimately, we believe this merger will preserve jobs and increase job security for workers not directly employed by the combined carrier by creating a more competitive, financially stable, and efficient airline.